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In the Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC., PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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I. FULL AVOIDED COST

A. Respondents assert (Br. 8-12) that the Commission, when it provided by rule that electric utilities must pay full avoided cost to qualifying facilities (in the absence of a waiver obtained by a state commission or a lower negotiated rate), ignored and violated the statutory requirement (in PURPA Section 210(b)) that rates "shall be just and reasonable to the electric consumers of the electric utility." This assertion wholly misconceives the meaning of the "just and reasonable to consumers" standard and misrepresents the Commission's decision in this case.

1. Respondents seem to read the "just and reasonable to consumers" standard as requiring that utilities pay qualifying facilities minimum rates consistent with a fair rate of return to those qualifying facilities, thus immediately passing on to utility consumers savings resulting from utility purchases from low-cost qualifying facilities. This reading would, in effect, impose traditional cost-of-service ratemaking concepts on purchases by utilities

from qualifying facilities. Congress, however, made it crystal clear that it did not wish to impose such traditional public utility ratemaking concepts on sales *by* qualifying facilities *to* utilities.[1] (Significantly, traditional cost of service concepts *were* to govern sales *by* utilities *to* qualifying facilities.[2]) The Conference Report stresses that qualifying facilities are not low-risk utilities guaranteed a fair return, but, rather, are enterprises fully at

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[1] The Conference Report states:

> It is not the intention of the conferees that cogenerators and small power producers become subject, by virtue of this ["just and reasonable to the electric consumers of the electric utility"] language, and the rules promulgated under this section, to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power. The conferees recognize that cogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activities generally or on the activities vis a vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable.
>
> The conferees wish to make clear that cogeneration is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications, but rather in a less burdensome manner. The establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production.

H.R. Conf. Rep. No. 95-1750, 95th Cong., 2d Sess. 97-98 (1978) (hereinafter "Conf. Rep."). See also J.A. 10-11.

[2] In its discussion of sales by utilities to qualifying facilities, the Conference Report states: "Here the phrase 'just and reasonable' is intended to refer to traditional utility ratemaking concepts. The conferees do not intend that the cogenerator or small power producer pay any more or any less than is otherwise just and reasonable in terms of the utility receiving the reasonable rate of return for providing services to those kinds of users." Conf. Rep. at 98.

risk when they generate power. Consequently, the Report explicitly states, the "just and reasonable to consumers" standard is not intended to subject the rates of qualifying facilities "to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate." Conf. Rep. at 97. The Report emphasizes that "*cogeneration is to be encouraged under this section*," and that traditional "reasonableness" concepts, rigidly tied to sellers' costs, would be a "significant disincentive to firms interested in cogeneration and small power production." *Id.* at 98 (emphasis added). In sum, it is clear that Congress did not intend, through the "just and reasonable" formula, to provide *immediate* rate-savings for utility consumers by requiring qualifying facilities from the beginning to pass on to such consumers all the benefits of low cost operations.

2. As the Conference Report makes clear, the "just and reasonable to consumers" standard must be understood in the context of *this* statute and *its* overriding purposes. Congress explicitly provided that the interests of utility consumers must be taken into account. It was equally explicit, however, that two other statutory factors —factors that respondents wholly ignore in their brief— must also be taken into account: rates are to be "in the public interest" and "shall not discriminate against" qualifying facilities. Even more important, the "just and reasonable" standard must be evaluated in light of the dominating purpose "that cogeneration is to be encouraged." Conf. Rep. at 98. Congress understood that, in the *long* run, electric utility consumers as well as the public at large would benefit if more low-cost qualifying facilities would come into existence. But to entice them to come into existence, rate structures must be such that, *ex ante*, no unnecessary disincentive is created for enterprises considering entry into this market. The Commission's judgment that, at the outset of this statutory enterprise, consumers should pay exactly what they would have paid in any event—(that is, would have paid in the ab-

sence of new qualifying facilities)—rather than sharing immediately in each cost-saving that any new entrant might be able to produce—is an eminently sensible judgment. It is, furthermore, reasonable and just to consumers precisely because it maximizes incentives for the entry of a large number of qualifying facilities into the relevant market; this is likely, over time, to drive down the utility's avoided costs and lead to lower retail rates for customers.[3] In sum, what the Commission concluded was that long-run savings to consumers could be provided by a rule that was consistent with the statute's fundamental purpose of conserving scarce energy resources by encouraging cogeneration and small power production, whereas a rule that insisted on immediate reductions for utility consumers would, in effect, endanger the goose that was promising to lay the golden egg.

3. Respondents assert (Br. 11) that the Commission's "full avoided cost" rule reduces the "just and reasonable" standard to "surplusage," as if the rule were somehow arrived at wholly independently of notions of reasonableness. This is an artificial reading of the record as a whole. The Commission Staff Paper leading to the proposed rules explicitly stated (J.A. 30 n.11):

> [W]e think that so long as the service being offered by a [Qualifying Facility] is fully comparable to the alternative, the payment to the cogenerator of the full cost of the alternative would be just and reasonable to the utility's customers. * * * We do *not* understand the prescription [in the Conference Report] that the proper price is the lower of the just

[3] The Commission's rules provide for periodic adjustments by utilities of the data on which avoided costs may be derived. 18 C.F.R. 292.302(b). In addition, the rules provide that "the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system" shall be taken into account in determining avoided costs. 18 C.F.R. 292.304(e)(2)(vi). Under the rules, actual adjustments in the full avoided cost rate are left to state regulatory authorities, who are charged with implementing the Commission's rules (see 16 U.S.C. (Supp. V) 824a-3(f); 18 C.F.R. 292.401(a)), or to the parties themselves through negotiation (see 18 C.F.R. 292.301(b)).

> and reasonable price and the avoided cost as requiring that the selling QF be restricted to a minimal mark-up from its marginal generation cost on its sales to a utility.

The Commission's careful evaluation of all the relevant factors (Pet. App. B-63 to B-66) evidently reflects its own conclusion that a full avoided cost rate would, under all the circumstances, be "just and reasonable" to consumers, as well as being "in the public interest" and otherwise serving the statutory purposes.

Respondents stress (Br. 9, 10-11) that the Conference Report states that purchase rate should be "the lower of" full avoided costs and a rate that satisfies the three-pronged statutory standard (including "just and reasonable to consumers"). In this respect that Report simply restates the statutory scheme and adds no new light. When respondents go on, however, to state that the Commission's rule in effect automatically chooses the higher of the two figures whenever these diverge, they show that they suffer from a misunderstanding. Nothing in the statute, nothing in the Report, and certainly nothing in the economics of rate making suggest that a statutory "just and reasonable" rate will always be at or below the full avoided cost of the *buying* entity. In the absence of the full avoided cost maximum, it would be quite possible and reasonable for the Commission to conclude that under some circumstances a rate *exceeding* full avoided cost would in fact be just and reasonable and in the public interest. It is in such a situation that the statutory maximum would cut in independently to set a ceiling on the Commission's authority.

B. Respondents repeatedly assert (Br. 12-18, 21-22, 25, 28) that the Commission failed to explain its rule and failed adequately to consider alternatives. Specifically, they fault the Commission for not taking into account production costs incurred by qualifying facilities (sometimes labeled "generic" costs). In this they echo the court of appeals' complaint that the Commission adopted a "simplistic and uniform conclusion that the full avoided cost

standard would be just and reasonable in every case" (Pet. App. B-9), and that it relied on a "uniform rule" (*id.* at B-10) rather than a "balancing of the interests" (*ibid.*). These assertions misconceive the regulatory task before the Commission and misrepresent the actual operation of the "full avoided cost" rule.

1. The Commission was faced with the task of creating a start-up regime for a new statutory enterprise, the central purpose of which was to encourage cogenerators and small power producers to enter the business of producing and selling power. It determined (Pet. App. B-65 to B-66) that traditional case-by-case cost of service rate-making would be so burdensome and difficult that, in the words of the Conference Report, it would be a "significant disincentive to firms interested in cogeneration and small power production." Conf. Rep. at 98. It decided, therefore, that—at least as a start-up measure—a general *rule*, rather than case-by-case rate-setting, was called for.

There is, of course, a sense in which *any* across-the-board rate not tied to individual costs is "arbitrary"; it *may*, in a given case, result in a windfall profit to a given low-cost producer—just as it may, in another case, exclude from the market a given high-cost producer. That sort of "arbitrariness" is simply a concomitant of the fundamental decision that an across-the-board general rate (rather than case-by-case rate adjudications based on seller costs) will best achieve the statutory purpose.

It should be noted, moreover, that the dangers of rigidity created by this form of regulation are significantly alleviated here by three major sorts of flexibility built into the Commission's rules:

(a) First, the full avoided cost rule applies only to purchases from "new capacity," *i.e.*, qualifying facilities whose construction was commenced after the enactment of PURPA. 18 C.F.R. 292.304(a)(1), (2). With respect to facilities that were in place or under construction before the passage of PURPA, rates may be set, on a flexible basis, at less than full avoided cost if it is

determined that a lower rate satisfies the statutory criteria and is sufficient to encourage cogeneration and small power production. *Id.* at 292.304(b)(3). The distinction reflects the Commission's sensitive appraisal of all relevant factors. Pre-existing cogenerators by definition do not need a PURPA rate to enter the market; and their costs are known and can more easily be taken into account in arriving at a reasonable rate. See Pet. App. B-67; J.A. 39. In the case of new capacity there is no history of costs, and an across-the-board rate not pitched to historical costs therefore makes most sense; such a solution is also consistent with the central purpose of PURPA to attract new entrants into the business of cogeneration and small power production.[4]

(b) The Commission carefully provided that state commissions are free to seek waivers of the full avoided cost rule. Respondents seek to minimize the impact of this provision (Br. 31-32); they ignore the fact that it is, precisely, state commissions (and not electric utilities) that naturally represent the interests of consumers.[5] If, over time, the operations of the full avoided cost rule come to result in some cases in unjustified exactions from consumers, or unjustified windfalls to a qualifying facility, the

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[4] Amicus curiae Edison Electric Institute (EEI) interprets the fact that applications for qualifying status have increased in number since the time of the court of appeals' decision as demonstrating that a full avoided cost rate is unnecessary to encourage cogeneration (EEI Br. 24). In fact the court of appeals stayed its mandate pending review in this Court, and the Commission's full avoided cost rule has continued in effect.

[5] It should be kept in mind that respondents and EEI (an investor-owned utility trade association) do not, in any sense, truly represent consumer interests. In fact, investor-owned utilities are in direct competition with cogenerators and small power producers as suppliers of electric power. If the cogeneration program is successful, utilities will build fewer generating plants of their own and will be prevented from adding to their own rate base (and, consequently, to their return on investment). Thus, it is in the interest of these utilities to discourage cogeneration and small power production. This is, of course, why PURPA was enacted.

waiver provision can be expected to come more and more fully into play.[6]

(c) Most significantly, as explained in our principal brief (at 22-23), the full avoided cost rule does not in fact require utilities to pay full avoided cost. It requires that they do so *in the absence of a negotiated lower rate.*[7] Given the overwhelming monopsony bargaining power of utilities—the very power that created the need for PURPA—it defies belief to assert that this permission to negotiate a rate below full avoided cost "is of limited practical benefit" (Resp. Br. 32).[8] In fact, in an important sense, the Commission's rules may in practice come to replicate the scheme of the statute itself, which explicitly allows the full avoided rate to serve as a *maximum.* Under the rules, too, that rate will operate as a ceiling, to be charged in the absence of a lower rate freely negotiated by the parties (or obtained by a state commission through a waiver). Sufficient flexibility is thus built into the system to alleviate the fear that long-term arbitrary rigidities will develop and that windfalls to qualifying facilities will result.

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[6] The fact that no waivers have so far been sought (see Resp. Br. 31) simply means that at this time state commissions agree with the Commission that a full avoided cost rate is needed to encourage this fledgling industry.

[7] Respondents suggest (Br. 32) that the right to negotiate a lower rate is irrelevant because "the question is whether rates *under the rule* are 'just and reasonable' to utility ratepayers" (emphasis in original). Respondents fail to comprehend that, while one section of the rule provides for a full avoided cost rate (18 C.F.R. 292.304), another section of the rule provides for negotiated contracts in lieu of that rate (18 C.F.R. 292.301). Thus both provisions are "under the rule" and are designed to operate in tandem.

[8] EEI itself adverts (Br. 24) to the fact that Southern California Edison Company has signed more than 60 contracts with cogenerators since the Commission's rules were enacted, and that most of them are at a rate below full avoided cost. This supports the Commission's conclusion that the full avoided cost rate merely serves as a context for bargaining (Pet. App. B-48 to B-49).

2. Given these flexibilities, complaints about the Commission's decision to initiate the regulatory scheme through an across-the board rate, rather than a method pitched to specific inquiries into specific costs, loses all plausibility. The question that does remain is whether the Commission adequately justified its judgment that that across-the-board rate should be the full avoided cost of the utility. Respondents assert that the Commission did not "explain" why it rejected a lower across-the-board rate, one set at some fixed percentage of avoided cost.[9] In fact, the Commission's explanation is clear and compelling. The Commission's central task of "encouraging" cogeneration and small power production had to be undertaken *ex ante*, in a world of uncertainties. The Commission had to set an "encouraging" rate all at once for thousands of highly various potential producers, many of them small enterprises for whom the question whether or not to enter the electric market would be marginal at best. The full avoided cost rule was plainly promulgated on the basis of a legitimate predictive judgment that, in this world of uncertainties at the start-up of this important legislative enterprise, a ceiling set at a lower rate might gratuitously discourage cogeneration and small power production, and might do so without obtaining significant countervailing benefits.[10] One cannot be certain that that

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[9] The further alternatives suggested by Respondents (Br. 14 n.10) merely constitute variations on the same themes. Setting rates on a "technology by technology" basis would require exactly the sort of painstaking inquiry into the actual and projected costs of innumerable sorts and sizes of possible cogenerators and small power producers that Congress sought to avoid; it would constitute cost-of-service ratemaking under another name. "[G]iving the state commissions a permisaible range of percentages" (*ibid.*) would simply pass through to those state commissions the requirement of imposing cost-of-service ratemaking on qualifying facilities; the left hand would then be undertaking the very task that, by hypothesis, has been deemed inappropriate for the right.

[10] Respondents' discussion (Br. 16) of potential savings is flawed by their significant overestimation of the extent cogeneration facilities are likely to be constructed in the next fifteen years—

judgment will stand the test of time (and that is why it must be seen as an experimental start-up rule to be re-evaluated in light of experience). On the other hand, any other rate—whether 80% or 90% or some other figure—would be subject to the same uncertainty.[11] Indeed, it is striking that the court of appeals' and respondents' criticisms of the full avoided cost rate could be replicated verbatim in the context of an 80% to 90% rate simply by changing the relevant figure that has supposedly not been adequately "explained." In fact, this case shows the extent to which that charge—"inadequate explanation"—has become a convenient surrogate for attacks on agencies' legitimate substantive judgments by private parties and courts eager to substitute for these judgments their own views of what is wise policy.

In sum, the full avoided cost rule maximizes the central statutory purpose to encourage cogeneration and small power production. It does so without a penny of

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particularly if rates are generally set below full avoided cost. The Commission has estimated that by 1995, the amount of new cogeneration capacity likely to be induced from a full avoided cost rate is approximately 12,000 MW (Pet. App. B-139). This compares with the utilities' planned resources to meet expected demand of 807,906 MW by 1995. See *Report of North American Electric Reliability Council, Electric Power Supply and Demand: 1982-1991* 34 (Table 13) (1982). Thus, new cogeneration may amount to less than 2% of the nation's total estimated electric generating capacity by 1995. A rule setting purchase rates at 95% (rather than 100%) of avoided cost would thus generate savings of only one-tenth of one percent.

[11] It must always be remembered that the Commission's task was to set a rate whose purpose was to attract thousands of highly variegated new firms into a difficult market—one that the utilities had, until the passage of PURPA, managed successfully to stifle—before a history of costs had been generated. In these circumstances, there is a sense in which "empirical evidence" to determine whether 80% or 90% or 100% is, in the abstract, the "correct" figure, does not exist. As the Commission's staff paper noted (J.A. 30 n.11), "we have difficulty in describing some particular price other than the avoided cost as being just and reasonable to the utility's customers * * *."

extra cost to consumers, who pay no more than what they would have in the absence of PURPA and the PURPA rate. And it secures for consumers and the country at large the principal benefit Congress sought to provide—the entry of new firms into the business of cogeneration and small power production.

II. INTERCONNECTION

A. Respondents' contention that Section 210 of the Federal Power Act (FPA) provides the exclusive means for ordering utilities to interconnect with qualifying facilities ignores the fundamentally different objectives of the two statutes. Section 210 of PURPA encourages the development of alternative energy sources. Section 210 of FPA seeks greater coordination among and reliability in the nation's bulk power transmission systems. Respondents, misreading the legislative history, confound these objectives. Their arguments, if accepted, would thwart the congressional purpose underlying Section 210 of PURPA.

1. Although FPA Section 210(a)(1) authorizes the Commission to order a utility to interconnect with a qualifying facility upon the latter's application, nothing in the statute indicates that the Commission may not also use its authority under Section 210(a) of PURPA to order interconnections necessary to facilitate the purchases and sales that the Commission is directed to encourage under the latter statute. Indeed, Section 212(e) of the Power Act, 16 U.S.C. (Supp. V) 824k(e) (emphasis added), which was enacted together with FPA Section 210, contains a savings clause that provides:

> (e) No provision of section [210] or [211] of this title shall be treated—
>
> (1) as requiring any person to utilize the authority of such section [210] or [211] of this title in lieu of *any other authority of law*, or
>
> (2) as limiting, impairing, or otherwise affecting any authority of the Commission under *any other provision of law*.

As the Commission correctly observed (Pet. App. B-60), FPA Section 212(e) "refutes the contention that section 210 of the Federal Power Act represents the exclusive method by which interconnection can be obtained." [12]

2. Respondents place heavy reliance (Br. 38-39) on certain statements in the legislative record by Administration spokesman David J. Bardin concerning the interconnection and cogeneration provisions of the Administration's proposed bill, S. 1469 (Part E) and H.R. 6831, 95th Cong., 1st Sess. (1977). Section 521 of that bill would have empowered the Commission to order a utility to interconnect with a qualifying cogenerator on the latter's application. Under Section 522, the Federal Energy Administration would have been authorized to issue rules regarding purchases and sales between utilities and qualifying cogenerators. Respondents assert that this division of regulatory authority reflects Congress' intent that the sole authority to order interconnections necessary to promote cogeneration would be contained in the interconnection provision, and not in the cogeneration provision, of the statute that ultimately was enacted.

The short answer to this argument is that the structure of the Administration bill was not carried forward in either the House or Senate bills, and it was from these

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[12] Respondents contend (Br. 45 n.61) that the Commission's view of the savings provision is at odds with a statement in the Conference Report that FPA Section 212(e) expresses the intention that "the authorities granted in [FPA] sections 210 and 211 are in addition to and not in lieu of other authority the Commission may have *under the Federal Power Act*." Conf. Rep. at 94 (emphasis added). The conferees' passing reference to the Commission's "Power Act" authority should not override the unambiguous reference in the savings clause to "any" other provision of law. In any event, the same report shows that the Committee did not draw fine distinctions between PURPA and the Power Act. Thus, a few pages earlier in the same report, the conferees refer to exemptions "under section 210(e) of the Federal Power Act" (Conf. Rep. at 39). This is clearly a reference to Section 210(e) of PURPA. In fact, the two statutes are inextricably intertwined. For example, the definitions of qualifying small power production facility and cogeneration facility applicable to Section 210 of PURPA are contained in Section 3 of the Power Act, 16 U.S.C. (Supp. V) 796(17), (18).

later bills, not the Administration proposal, that the conference agreement evolved. (See App., *infra*, 1a-14a, for the pertinent provisions of these bills.) Both the House and Senate bills contained interconnection provisions that would have empowered the Commission to order electric utilities (broadly defined to include otherwise nonjurisdictional utilities) to interconnect and coordinate with other utilities or with qualifying facilities. H.R. 8444, § 541(b), 95th Cong., 1st Sess. (1977); Senate amendment to H.R. 4018, § 122(a), 95th Cong., 1st Sess. (1977). Further, as noted in our opening brief (at 43), the cogeneration section of the House bill contained its own interconnection provision. H.R. 8444, § 546. The cogeneration section of the Senate bill (Senate amendment to H.R. 4018, § 113(a)), on the other hand, made no reference to interconnections—a natural omission, since that section would only have authorized the Secretary of Energy to *recommend* to state regulatory authorities the adoption of guidelines concerning cogeneration. Thus, Mr. Bardin's comments, relating to the unreported and unenacted Administration bill—comments that, in context, in any event do not support respondents' position [13] —cannot control the interpretation of the statutes as ultimately enacted. See *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 382 n.11 (1969); *Hardin* v. *Kentucky Utilities Co.*, 390 U.S. 1, 11 (1968).[14]

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[13] When viewed in proper perspective, Mr. Bardin's statements demonstrate that the Administration viewed bulk power transmission problems, necessitating new Commission interconnection authority, as distinct from the barriers hindering the development of cogeneration. See S. Rep. No. 95-442, 95th Cong., 1st Sess. 32-33 (1977); *Public Utility Rate Proposals of President Carter's Energy Program: Hearings on S. 122, S. 1300, S. 1363, S. 1469 (Part E) Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources*, 95th Cong., 1st Sess. (Pt. 1) 187-192 (1977); *National Energy Act: Hearings on H.R. 6831, et al. Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 95th Cong., 1st Sess. (Pt. 3) 89-94 (1977).

[14] Respondents' reliance (Br. 39-40) on an analysis of the Administration bill prepared by the Congressional Office of Technology

3. Contrary to respondents' arguments (Br. 41-43), the changes in the legislation that were made in conference undermine, rather than support, respondents' position.

a. First and foremost, respondents' assertion, that the Commission must hold a full adjudicative "public interest" hearing under FPA Section 210 before ordering an interconnection in every case in which a qualifying cogenerator or small power producer seeks to hook up with a utility for purposes of making purchases and sales pursuant to PURPA Section 210, rests on a wholly distorted understanding of the latter provision. Section 210 of PURPA was the product of a compromise between two quite different legislative approaches. Under the House bill, state regulatory authorities would have been permitted, but not required, to enforce the Commission's rules concerning cogeneration; if the state authorities chose not to do so, the regulatory burden would have been borne directly by the federal government. See H.R. Rep. No. 95-496 (Pt. 4), 95th Cong., 1st Sess. 157 (1977). In contrast, under the Senate version, the federal role in promoting cogeneration was limited to recommending that the states adopt guidelines governing purchases and sales between cogeneration facilities and utilities. The Senate approach, fashioned in response to widespread criticism of the House proposal, sought to encourage the development of cogeneration facilities without federal preemption. See S. Rep. No. 95-442, 95th Cong., 1st Sess. 14 (1977).

In Section 210 of PURPA, the conference adopted the House approach requiring promulgation of federal rules, *but retained the Senate approach providing for state*

Assessment is irrelevant for the same reason. Nor does the statement of former Commission Chairman Charles Curtis (Resp. Br. 40-41) support respondents' position. Mr. Curtis' statement cannot be construed as suggesting that Section 541 of H.R. 8444, the interconnection provision of the bill that subsequently passed the House, would have provided the sole authority for the Commission to order utilities to interconnect with qualifying facilities, since, as noted above, Section 546, the cogeneration provision of the same bill, expressly provided for interconnection rules.

implementation of the regulatory program. (It was this requirement of state implementation that was at issue before this Court last Term in *FERC* v. *Mississippi*, 456 U.S. 742 (1982).) This was, in other words, a deliberate policy choice in favor of *decentralized* implementation of the congeneration program at the *state* level. Given this choice, it is inconceivable that Congress, in enacting Section 210 of PURPA in order to encourage cogeneration, would have intended to require owners of qualifying facilities—many of them small operations by definition [15]—to appear at a full evidentiary hearing before the Federal Energy Regulatory Commission in Washington, D.C., every time they wished to obtain an order requiring a utility to interconnect for the purpose of making purchases and sales pursuant to Section 210 of PURPA. Yet this result is the inevitable consequence of respondents' construction of the statute.

b. Respondents point out (Br. 43 n.57) that the Conference Committee deleted, from the cogeneration section of the House bill, the provision directing the Commission to promulgate rules "respecting the interconnection of a qualifying cogeneration facility to the distribution system of any electric utility" (H.R. 8444, § 546(a)(2)). They argue that the deletion suggests that Congress meant to deprive the Commission of authority to issue an interconnection rule under PURPA Section 210(a). But at the same time the conferees deleted this provision, they granted the Commission the authority, in Section 210(a) of PURPA, to prescribe "such rules as it determines necessary to encourage cogeneration and small power production * * *." 16 U.S.C. (Supp. V) 824a-3(a). By directing the Commission to "encourage" cogeneration (a directive that was not included in either the House or Senate bills) and by leaving to the Commission's determination the choice of rules necessary to reach that objective, Congress clearly meant to give the Com-

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[15] See 16 U.S.C. (Supp. V) 796(17)(A)(ii) (defining small power production facility as one with a production capacity of no more than 80 megawatts).

mission broader rather than narrower authority to prescribe rules necessary to carry out the statutory mandate of removing the existing institutional and regulatory impediments to cogeneration and small power production and to promote the development of these technologies.

c. Respondents also contend (Br. 41-43) that, insofar as the Commission retains authority under PURPA Section 210 to order interconnections, that authority is limited to ordering interconnections for purposes of sales by utilities to qualifying facilities only, and not for purposes of purchases by utilities from qualifying facilities. This contention rests on respondents' perceived distinction between the "transmission" and "distribution" facilities of a utility. According to respondents, distribution facilities in this context are used only to send power from a utility to a qualifying facility, whereas transmission facilities are used only to send power from a cogenerator to a utility. Because the deleted provision of the cogeneration section of the House bill referred to interconnections with the "distribution system" of a utility, respondents urge that PURPA Section 210 at most authorizes the Commission to issue rules governing those interconnections necessary to send power from the utility to the cogenerator. On the other hand, in respondents' view, Section 210(a)(1)(A) of the Power Act—which empowers the Commission to order a utility to interconnect its "transmission facilities" with the facilities of a qualifying facility—is the sole authority by which the Commission may order interconnections necessary to send power from the cogenerator to the utility.

Respondents' version of the distinction between "transmission" and "distribution" facilities finds no support in the statute and is contrary to the usage of the industry. Transmission facilities are commonly regarded as including the high voltage transmission grid that connects a utility's generation facilities with its load centers and as not including the low voltage distribution system that is

used to distribute power to end users.[16] Utilities sell power via transmission facilities as well as via distribution facilities.[17] They can buy power via distribution as well as transmission facilities. Thus, the terms "distribution" and "transmission" do not distinguish between the utility as seller or buyer, but between low voltage and high voltage systems. It therefore follows that Section 210 of the Power Act refers to interconnections with the "transmission facilities" (but not the distribution facilities) of utilities precisely because Congress, in that provision, was addressing problems associated with high voltage bulk power transmission and coordination.

If, as respondents assert, FPA Section 210 is the exclusive means by which qualifying cogenerators and small power producers can seek interconnections for the purpose of selling electricity to utilities, there would exist a significant gap in the statute. Although the largest industrial cogenerators (some of them capable of cogenerating more than 1,000 megawatts) could tie into high voltage transmission lines, most qualifying facilities—particularly small power producers—generate much less power and could not economically increase their voltage to connect with these lines. As a practical matter, therefore, qualifying facilities in most cases will have to be connected to the utility's distribution system at distribution voltages for purposes of both selling to and purchasing

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[16] See *Glossary of Important Power and Rate Terms, etc.* (FPC 1965), defining "transmission" as "the movement or transfer of electric energy in bulk. Ordinarily the transmission movement is considered to end when energy is transformed for distribution to ultimate consumers." Bulk power is high voltage power. Thus, "transmission" of power requires high voltage lines. Distribution networks, in contrast, carry low voltage power that can be used by customers. See *Southern California Edison*, 20 F.E.R.C. (CCH) ¶ 61,301 (Sept. 10, 1982). See also generally *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515 (1945).

[17] Indeed, the FPA explicitly authorizes the Commission to order utilities to "sell" (as well as exchange) electricity over their "transmission" lines. See 16 U.S.C. 824a(b); 16 U.S.C. (Supp. V) 824i(a)(1)(C).

from the utility. Under respondents' view of the statute, most qualifying facilities would be powerless to obtain an interconnection with a utility for the purpose of selling their surplus power at distribution voltage levels.

B. Respondents argue (Br. 35-37, 43, 45 & n.61) that the Commission's interconnection rule, 18 C.F.R. 292.303(c), constitutes an "exemption" from Section 210 of the Power Act and is therefore prohibited by Section 210(e)(3)(B) of PURPA. The latter section provides that, although the Commission generally may exempt qualifying facilities in whole or in part from the Power Act and from certain other state and federal laws, no qualifying facility "may be exempted" from, *inter alia*, "the provisions of section 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act." 16 U.S.C. (Supp. V) 824a-3(e)(3)(B).

1. The language of Section 210(e)(3)(B) plainly supports the Commission's view (Pet. App. B-180 to B-182) that it was enacted to preclude the Commission from exempting qualifying facilities as *targets* of interconnection orders, and that the provision has nothing to do with cogenerators as applicants for such orders.[18] "To exempt" is defined as "to relieve, excuse or set free from a duty or service imposed upon the general class to which the individual exempted belongs." *Black's Law Dictionary* 513 (5th ed. 1979). Nothing in the Commission's interconnection rule purports to relieve qualifying facilities from any "duty or service" under Section 210 of the Power Act.[19] Section 210 of the Power Act continues to apply to

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[18] Moreover, the statutory language barring exemptions for qualifying facilities from "the necessary authorities for *enforcement*" of FPA Section 210 makes no sense at all in the context of these facilities as applicants.

[19] Indeed, the section of the Commission's rules that deals with exemptions explicitly states that any qualifying facility "shall be exempt from all sections of the Federal Power Act, except," *inter alia*, "Sections 210, 211 and 212." 18 C.F.R. 292.601(c)(2).

qualifying facilities according to its terms in the same way it would have applied had the Commission not prescribed its interconnection rule under PURPA.[20]

2. The plain reading of the statute is bolstered by the legislative history, which shows that it was not until the interconnection section of the legislation included qualifying facilities as potential *targets* that Congress inserted in the cogeneration section a limitation on the Commission's authority to exempt qualifying facilities from the provisions of the Power Act.

Both the House and Senate bills included qualifying cogenerators and small power producers as potential applicants for orders directing electric utilities to interconnect, but did not include qualifying facilities as possible targets. H.R. 8444, § 541(b); Senate amendment to H.R. 4018, § 122(a). Neither bill contained any limitation on the Commission's authority to exempt qualifying facilities from the provisions of the Federal Power Act. H.R. 8444, § 546(e); Senate amendment to H.R. 4018, § 113(b). The obligation of qualifying facilities to interconnect when ordered to do so was first included in the legislation by the conferees, who, at the same time, included the limitation on the Commission's authority to exempt qualifying facilities from the provisions of the Power Act.

These developments compel the conclusion that when the conferees decided to make qualifying facilities potential *targets* of the Commission's new authority to require coordination of bulk power transmission systems, they ensured that such facilities could not be exempted from these

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[20] Section 210 of PURPA does not require qualifying facilities to sell electricity. It simply requires *utilities* to offer both to sell electricity to, and purchase electricity from, qualifying facilities. Under Section 210(a) of the Power Act, however, the Commission may compel any cogeneration or small power production facility (whether a qualifying facility or not) to sell or exchange energy, even though the facility might prefer to sell to another party or to consume all of its power itself.

new obligations.[21] There is no meaningful evidence that the conferees also intended this limitation on the Commission's exemption authority to be transformed into a crippling encumbrance on the power of the Commission to encourage cogeneration by issuing a rule ordering utilities to interconnect with qualifying facilities.[22]

CONCLUSION

For the foregoing reasons and those presented in our opening brief, it is respectfully submitted that the judgment of the court of appeals should be reversed.

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[21] This is reflected in the language of the pertinent statutory provisions. Section 210(e)(3)(B) of PURPA provides that no qualifying "facility" may be exempted from the provisions of FPA Section 210. The latter section, in turn, provides that any cogeneration or small power production "facility" may be the *target* of an interconnection order. In contrast, FPA Section 210 describes potential *applicants* for interconnection orders as any qualifying "cogenerator" or "small power producer." These terms are not interchangeable. Congress carefully defined each of them separately in Section 3 of FPA, 16 U.S.C. (Supp. V) 796(17), (18).

[22] Respondents and EEI argue that Congress addressed specific safety and reliability concerns in FPA Section 210 and that resort to PURPA Section 210 as authority for a cogeneration interconnection rule improperly circumvents the reliability safeguards contained in FPA Section 210. In Section 210(a) of PURPA, however, Congress specifically directed the Commission to include in its rules provisions regarding reliability. The Commission's rules provide that, on the recommendation of any electric utility, any state regulatory authority "may establish reasonable standards to ensure system safety and reliability of interconnected operations." 18 C.F.R. 292.308.

APPENDIX *

1. **The Administration bill,** S. 1469 (Pt. E) and H.R. 6831, 95th Cong., 1st Sess. (1977), provided in pertinent part:

Interconnection and Wheeling

Sec. 521. (a) Section 202(b) of the Federal Power Act is amended to read as follows:

"(b) (1) Whenever the Commission, on its own motion, or upon application of any State commission or of any electric utility or any qualifying cogenerator (as defined in Section 522(b)(2) of the Public Utility Act of 1977), and after notice to each State commission and electric utility affected and after evidentiary hearing, finds such action necessary or appropriate in the public interest, it shall by order direct an electric utility—

> "(A) to establish physical connection of its transmission facilities with the facilities of any other electric utility or qualifying cogenerator, or
>
> "(B) (i) to sell or deliver energy to, (ii) exchange energy with, (iii) transmit energy for, (iv) provide pooling, wheeling, or other transmission services for, or (v) otherwise coordinate with, such utility or cogenerator.

"(3) The Commission may prescribe the terms and conditions of the arrangement to be made between the persons affected by any order under this subsection, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them.

"(4) The Commission shall have no authority under this subsection to compel the enlargement of generating facilities for purposes of this subsection, nor to compel

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* The pertinent provisions of the statute as enacted are set forth in an appendix to our main brief (at 1a-15a).

an electric utility to sell or exchange energy if to do so would unreasonably impair its ability to render adequate service to its customers."

(b)(1) Section 202(a) of the Federal Power Act is amended by striking the word "voluntary" from the first sentence.

(2) The first sentence of section 201(b) is amended by inserting "(other than 202(b))" after "Part" and by adding the following at the end thereof: "The provisions of section 202(b) shall apply to the electric utilities and other persons specified therein."

(3) Section 201(e) is amended by inserting "(other than facilities subject to such jurisdiction solely by reason of section 202(b))" before the period at the end thereof.

Cogeneration

Sec. 522. (a) Not later than one year after the date of enactment of this Act, the Administrator shall, after consultation with representatives of State regulatory authorities, prescribe rules requiring electric utilities to offer to sell electric energy to any qualifying cogenerator and to offer to purchase electric energy from such cogenerators. Such rules shall insure that rates for such sales and purchases do not discriminate against such cogenerators, and may, in order to carry out the purposes of this Act, include provisions exempting qualifying cogenerators in whole or part from the Federal Power Act, the Public Utility Holding Company Act, and from State laws and regulations respecting electric utility regulation, if the Administrator determines such exemption is necessary to carry out the purposes of this part.

(b) For purposes of this section:

(1) The term "cogeneration facility" means a facility owned by a person not primarily engaged in the generation or sale of electric power, which facility produces (A) electric energy and (B) other forms of useful energy (such as steam or heat)

which is, or will be used for industrial, commercial, or space heating purposes.

(2) The term "qualifying cogeneration facility" means a cogeneration facility which the Administrator determines—

(A) meets such requirements (including requirements respecting minimum size, fuel use, and fuel efficiency) as the Administrator, by rule, prescribes; and

(B) the owner or operator of which offered (at such time and in such manner as the Administrator may prescribe by rule) each electric utility to which such facility is, or will be, directly connected an opportunity to operate such facility on terms which are agreed upon by the parties.

(3) The term "qualifying cogenerator" means any person who is, or will be, the owner or operator of a qualifying cogeneration facility.

(c) For purposes of enforcement of this section, a rule under this section shall be treated as a rule under the Federal Power Act; except that, for such purposes, any reference in sections 309, 314, 315 and 316 of the Federal Power Act to the Commission shall be deemed to be a reference to the Administrator.

(d) The Administrator may delegate (on such terms and conditions as he determines appropriate) any part of his authority under this section respecting any electric utility (other than a Federal agency) to any State regulatory authority which he determines has the capability of effectively exercising such authority with respect to such utility.

2. **The Senate bill,** Senate amendment to H.R. 4018, 95th Cong., 1st Sess. (1977), provided in pertinent part:

COGENERATION, BACK-UP POWER, AND SMALL POWER PRODUCERS

SEC. 113. (a) Not later than one year after the date of enactment of this subtitle, the Secretary of Energy shall, after consultation with representatives of State regulatory authorities, electric utilities, cogenerators, and small power producers recommend to the State regulatory authorities guidelines requiring, where he deems appropriate, electric utilities to offer to sell electric energy to any qualifying cogenerator or small power producer and to offer to purchase electric energy from such cogenerators or small power producers. Such recommendations shall include procedures to insure that rates for such sales do not discriminate against such cogenerators or small power producers or against the customers of the utility or utilities. Such guidelines may not require an electric utility to purchase electric energy from a qualifying cogenerator or small power producer during any period at a rate which exceeds the highest incremental cost at which such utility generates electric energy or purchases electric energy from any other source, during such period. Such guidelines shall not authorize any cogeneration facility to make any sale for purposes other than resale.

(b) Not later than one year after the date of enactment of this subtitle, the Secretary of Energy shall, after consultation with representatives of State regulatory authorities, electric utilities, cogenerators, and small power producers, prescribe rules exempting qualifying cogenerators and small power producers in whole or in part from the Federal Power Act and/or the Public Utility Holding Company Act, if the Administrator determines such exemption is necessary to carry out the purposes of this subtitle: Provided, however, That power producers of over thirty megawatts may not be exempt from the Federal Power Act: And provided further,

That a Federal license must still be required under the Federal Power Act, regardless of whatever other exemptions may be granted.

(c) Not later than one year after the date of enactment of this subtitle, the Secretary of Energy shall, after consultation with representatives of State regulatory authorities, electric utilities, and alternative energy industries and consumers, recommend to State regulatory authorities guidelines for the purpose of preventing utilities from engaging in any conduct which results in unreasonable or discriminatory rate or pricing structures or practices against consumers that utilize power facilities or sources other than those provided or otherwise supplied by any such utility including, but not limited to solar, geothermal, photovoltaic, wind, and other power sources as the Secretary may decide.

(d) For the purposes of this section, the term—

(1) "cogeneration facility" means a facility owned by a person not primarily engaged in the generation or sale of electric power (other than in connection with the ownership or operation of cogeneration facilities or small power production facilities), which facility produces (A) electric energy and (B) other forms of useful energy (such as steam or heat) which is or will be used for industrial, commercial, or space heating purposes: Provided, however, That nothing in this section is meant to prevent utilities from producing electricity by cogeneration;

(2) "qualifying cogeneration facility" means a cogeneration facility which the Administrator determines meets such requirements (including requirements respecting minimum size, fuel use, and fuel efficiency) as the Administrator, by rule, prescribes;

(3) "qualifying cogenerator" means any person who is, or will be the owner or operator of a qualifying cogeneration facility;

(4) "small power production facility" means a facility owned by a person not primarily engaged in

the generation or sale of electric power (other than in connection with the ownership or operation of cogeneration facilities or small power production facilities), which facility produces only electric energy by the use of solid waste and/or renewable resources. Such a facility may not be larger than eighty megawatts. Such term includes, but is not limited to—

(A) existing dams not used for electric generation within the past five years;

(B) solar electric systems;

(C) wind systems;

(D) production of electric energy from solid waste;

(E) electric energy storage facilities operated in connection with such a small power production facility; and

(F) production of electric energy from wood;

(5) "qualifying small power production facility" means a small power production facility which the Administrator determines meets such requirements (including requirements respecting fuel use, fuel efficiency, and technical reliability) as the Administrator, by rule, prescribes;

(6) "qualifying small power producer" means any person who is, or will be, the owner or operator of a qualifying small power production facility; and

(7) "incremental cost" of a unit of electricity means the additional cost that would be incurred by a utility if the utility had generated the unit of electricity with its then available generation capacity or capacity available to it.

INTERCONNECTION

SEC. 122. (a) Section 202 of the Federal Power Act is amended by adding a new subsection (g) to read as follows:

"(g) (1) Whenever the Commission, upon application of any State Regulatory Authority or any qualifying cogenerator as defined in the Public Utilities Regulatory Policy Act of 1977 or any electric utility, and after notice to each State regulatory authority, qualifying cogeneration [sic] or electric utility affected and after opportunity for hearing, finds such action necessary or appropriate to carry out the purposes of paragraph 2(a) or 2(b) of the Public Utilities Regulatory Policy Act of 1977, it may by order direct an electric utility (other than a Federal agency), to establish physical connection of its transmission facilities with the facilities of any other electric utility or qualifying cogenerator; and to order such utility or qualifying cogenerator to sell energy to, to exchange with, and otherwise to coordinate with parties only as necessary to effectuate the intent of the interconnection.

"(2) Prior to issuing an order under the authority of this subsection, the Commission shall inform the parties of its intent to issue such order and shall set a reasonable time for the terms and conditions of agreements among the parties affected by such order to be determined by negotiation among said parties: Provided, That said terms and agreements shall be subject to approval by the Commission and in the event that the parties do not reach an agreement approved by the Commission, the Commission may prescribe the terms and conditions of the agreement among the parties affected by such agreement, including the apportionment of cost among them and the compensation or reimbursement reasonably due to any of them: And provided further, That if in the Commission's judgment, time is of the essence, the Commission may issue an order under the authority of this subsection prior to or during the negotiations among the parties.

"(3) The Commission shall have no authority under this subsection to—

"(A) compel the enlargement of generating facilities for purposes of this subsection, or

"(B) take any action that would result in an uncompensated economic loss to the electric utility or its customers, place an undue burden on such utility, unreasonably impair the reliability of the system of any utility, or impair its ability to render adequate service to its customers,

"(4) Except as provided in this subsection, compliance by any electric utility with an order issued under this subsection shall not subject any electric utility to regulation under the Federal Power Act if any such electric utility is not otherwise subject to regulation under such Act.

"(5) For the purposes of this subsection the term 'electric utility' means a utility as defined in the Public Utilities Regulatory Policy Act of 1977 which sells or exchanges electric energy.".

(b)(1) The first sentence of section 201(b) is amended by inserting "other than section 202(g))" after "Part" and by adding the following at the end thereof: "The provisions of section 202(g) shall apply to the electric utilities and other persons specified therein.".

(2) Section 201(e) is amended by inserting "(other than facilities subject to such jurisdiction solely by reason of section 202(g))" before the period at the end thereof.

(c) Upon the effective date of the Department of Energy Organization Act (Public Law 95-91) the authorities vested in the Federal Power Act by this section shall be transferred to and vested in the Federal Energy Regulatory Commission.

3. **The House bill**, H.R. 8444, 95th Cong., 1st Sess. (1977), provided in pertinent part:

INTERCONNECTION, POOLING, WHEELING, AND CENTRAL DISPATCH

SEC. 541. (a) REGIONAL DISTRICTS.—Section 202(a) of the Federal Power Act is amended:

(1) by striking the word "voluntary" from the first sentence; and

(2) by inserting "for the purpose of assuring the goals set forth in this part and to assure maximum competitive opportunities for the purchase and sale of electric energy at wholesale at the lowest possible cost" immediately after "districts" in the third sentence.

(b) Section 202(b) of such Act is amended to read as follows:

"(b) (1) Whenever the Commission, on its own motion or upon application of any State commission or of any electric utility or the owner or operator of any qualifying cogeneration facility (as defined in section 546(b)(2) of the Public Utilities Regulatory Policy Act of 1977), and after public notice and notice to each State commission and electric utility directly affected and after evidentiary hearing, finds it necessary or appropriate in the public interest, it shall by order direct an electric utility to—

"(A) establish physical connection of its transmission facilities with the facilities of any other electric utility or qualifying cogenerator, or

"(B) (i) sell or deliver energy to or exchange energy with,

"(ii) provide pooling for,

"(iii) provide wheeling, or otherwise transmit energy for, or

"(iv) otherwise coordinate with,

such utility or cogenerator. For purposes of this paragraph, the term 'wheeling' means transmission of electric energy among electric utilities and qualifying cogeneration facility [sic] (as defined in section 546(b)(2) of the Public Utilities Regulatory Policy Act of 1977), but such term does not include the transmission of electric energy to an ultimate consumer (other than to a qualifying cogenerator for purposes of providing backup power, as determined by the Commission).

"(2) No order may be issued under subparagraph (A) of paragraph (1) unless the Commission determines that—

> "(A) such order will benefit consumers of an electric utility by reducing costs of supplying electric energy to such consumers or will otherwise provide public benefits in assuring that supplies of electric energy are generally made available with greater economy and with regard to the proper utilization and conservation of natural resources, and
>
> "(B) no utility subject to such order or consumers of such utility will suffer economic hardship thereby.

The Commission may not issue an order under paragraph (1) upon application of any electric utility or the owner or operator of any qualifying cogeneration facility to direct an electric utility to establish physical connection or to provide wheeling services unless the electric utility or qualifying cogeneration facility which makes an application for such connection or wheeling demonstrates to the Commission that such electric utility or owner or operator of any qualifying cogeneration facility is ready, willing, and able to provide reimbursement reasonably due for the costs (including capital and operating costs) incurred by the electric utility or owner which is requested to make physical connection or to wheel electric energy.

"(3) Whenever the Commission, on its own motion or upon application of any electric utility within a regional district established under this Act, and after public notice

and notice to each State commission and electric utility directly affected and after evidentiary hearing, finds such action necessary or appropriate in the public interest it may by order direct any electric utility owning or operating any bulk power transmission facility located (in whole or in part) within such district to increase the transmission capacity of such facility.

"(4)(A) With respect to each regional district established under this Act in which a centrally dispatched power pool in [sic] not operating, upon its own motion or upon application the Commission shall commence a proceeding to determine whether requiring operation of such a power pool in such area is technologically and economically feasible and in the public interest. To the extent that the Commission determines, after public notice and notice to each State commission and after evidentiary hearing, that operation of such a pool is technologically and economically feasible and in the public interest, the Commission shall by order require operation of such a pool.

"(B) For purposes of subparagraph (A), the term 'centrally dispatched power pool' means—

"(i) a power pool which utilizes a central dispatch system for all generation facilities (other than cogeneration facilities which are not required to be included as provided under regulations under section 546(a)(2) of the Public Utilities Regulatory Policy Act of 1977) in a regional district and in which, to the extent technologically and economically feasible as determined by the Commission, each electric utility which owns or operates a bulk power generation facility in such region participates, or

"(ii) an exchange or other system which the Commission determines is more effective or substantially as effective as a power pool referred to in clause (i) in assuring the most economical utilization of generation and transmission facilities in such area.

"(C) For purposes of subparagraph (B), the term 'central dispatch system' means a centrally coordinated

system for controlling the generation and transmission of electric power in an area which system is designed to obtain the most economical utilization of generation and transmission facilities in such area.

"(5) The Commission shall prescribe the terms and conditions of the arrangement to be made between the persons affected by any order under this subsection, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them if the parties fail to agree to such terms and conditions.

"(6) The Commission shall have no authority under this subsection to compel the enlargement of generating facilities for purposes of this subsection, nor to compel an electric utility to take any action under paragraph (1) if the Commission determines that to do so would impair the ability of the electric utility to render adequate service to its customers.".

(c) APPLICATION OF FEDERAL POWER ACT.—(1) The first sentence of section 201(b) of such Act is amended by inserting "(other than sections 202(b), relating to interconnection, pooling, wheeling, and central dispatch, and 205(k), relating to unfair competition)" after "Part" and by adding the following at the end thereof: "The provisions of sections 202(b) and 205(k) shall apply to the electric utilities and other persons specified therein.".

(2) Section 201(e) of such Act is amended by inserting "(other than facilities subject to such jurisdiction solely by reason of section 202(b) and 205(k))" after "Part".

COGENERATION

SEC. 546. (a) COGENERATION RULES.—Not later than 1 year after the date of enactment of this title, the Commission shall, after consultation with representatives of State regulatory authorities, and after a reasonable opportunity for other interested persons to submit oral as well as written data, views, and arguments, prescribe rules requiring electric utilities to offer to sell electric energy to the owner or operator of a qualifying cogenera-

tion facility and to offer to purchase electricity [sic] energy from such owner or operator. Such rules shall insure that rates for such sales and purchases are just, reasonable, or in the public interest, and do not discriminate against cogeneration. Such rules shall include—

(1) rules for allocating costs of a qualifying cogeneration facility between those incurred in generating electric energy and those incurred in generating other forms of energy;

(2) rules respecting the interconnection of a qualifying cogeneration facility to the distribution system of any electric utility or to a centrally dispatched power pool as defined in section 202(b)(4)(B) of the Federal Power Act;

(3) rules respecting the responsibility of the owner or operator of a qualifying cogeneration facility during periods of electric shortage;

(4) rules respecting the minimum reliability standards for the qualifying cogeneration facility; and

(5) rules which specify the reliability of emergency electric energy service available to the qualifying cogeneration facilities.

Such rules may not (A) require an electric utility to purchase electric energy from a qualifying cogeneration facility during any period at a rate which exceeds the highest cost at which such utility generates electric energy, or purchases electric energy from any other source, during such period, or (B) authorize such cogeneration facility to make any sale for purposes other than resale.

(b) DEFINITIONS.—For purposes of this section:

(1) The term "cogeneration facility" means a facility which produces—

(A) electric energy, and

(B) other forms of useful energy (such as steam or heat) which is, or will be, used for industrial, commerial, or space heating purposes.

(2) The term "qualifying cogeneration facility" means a cogeneration facility which the Commission determines—

(A) meets such requirements respecting minimum size and fuel efficiency as the Commission, by rule, prescribes; and

(B) in the case of a cogeneration facility which is not owned by a utility and which is, or will be, directly connected to an electric utility, the owner or operator of such facility has offered such utility an opportunity to construct and operate such facility on terms acceptable to such owner or operator.

(c) ENFORCEMENT.—For the purposes of enforcement, a rule under this section shall be treated as a rule under the Federal Power Act.

(d) DELEGATION TO STATES.—The Commission may authorize (on such terms and conditions as it determines appropriate) any State regulatory authority to exercise any part of the Commission's authority under this section if the Commission determines that such State regulatory authority has the capability of effectively exercising such authority within its jurisdiction.

(e) EXEMPTION FROM FEDERAL POWER ACT.—Not later than 1 year after the date of enactment of this title, the Commission shall, after consultation with representatives of State regulatory authorities, prescribe rules exempting qualifying cogenerators in whole or part from the Federal Power Act, the Public Utility Holding Company Act, and from State laws and regulations respecting electric utility regulation, if the Commission determines such exemption is necessary to carry out the purposes of this title. No such exemption shall be modified, except for good cause shown, with respect to any such cogenerator after such exemption takes effect with respect to such cogenerator.

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